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BEFORE THE
Federal Communications Commission
WASHINGTON, D.C.

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
Implementation of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
	)	
Rate Regulation	)	
	)	
Third Notice of Proposed Rulemaking	)	

COMMENTS OF TIME WARNER ENTERTAINMENT COMPANY, L.P.

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Its Attorneys

September 30, 1993

SUMMARY

Time Warner reiterates its concern that the database and computation methodology upon which the benchmark rates and the benchmark curve are based are fundamentally flawed. A channel addition/deletion methodology that utilizes the benchmark curve will reflect the same fundamental infirmities. Time Warner therefore believes that new channels should be added at the "new" benchmark rate and that the pre-addition rate should prevail for existing channels. Moreover, no matter what methodology is adopted, it should be applied on a tier-specific basis to prevent anomalous results.

Time Warner strongly opposes the Commission's suggestion that cable operators should be forced to elect either cost-of-service or benchmark regulation for all regulated tiers. The perceived evil that the proposal is designed to address -- namely to prevent cable operators from 'gaming' the regulatory process -- was eliminated when programming cost increases were afforded external treatment.

In addition, Time Warner believes that external cost treatment should be afforded to all upgrades required or agreed to by franchising authorities. Such upgrade costs represent an investment in service and plant that will benefit consumers. Indeed, that such upgrades have been approved by franchising authorities implies that their benefits justify the costs to subscribers.

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Comments of Time Warner Entertainment Company, L.P.

Time Warner Entertainment Company, L.P. ("Time Warner"), by its attorneys, hereby files its comments in response to the Third Notice of Proposed Rulemaking in this proceeding.[1] Time Warner is a partnership, which is primarily owned (through subsidiaries) by Time Warner Inc., a publicly traded Delaware corporation. Time Warner comprises principally three unincorporated divisions: Time Warner Cable, which is the second largest operator of cable television systems nationwide; Home Box Office, which operates pay television programming services; and Warner Bros., which is a major producer of theatrical motion pictures and television programs. Time Warner Cable, which owns

[1] Implementation of Rate Regulation Sections of the Cable Television Consumer Protection and Competition Act of 1992, First Order on Reconsideration, Second Report and Order and Third Notice of Proposed Rulemaking, MM Dkt. No. 92-266 (rel. Aug 27, 1993) ("Third Notice").

and operates cable systems in approximately 1,500 franchise areas throughout the United States will be directly affected by rules the Commission adopts regarding the regulation of cable rates. An active participant in all phases of this docket to date, Time Warner is an interested party in this proceeding.[2]

I. Benchmark Adjustments Due to Channel Addition or Deletion

The Third Notice discusses three channel addition/deletion benchmark adjustment proposals. Time Warner believes that the superior approach is the first one identified by the Commission, i.e., the proposal to require cable operators to add new channels at the "new" benchmark rate, while retaining the then currently permitted charge for existing channels.[3] This method would fulfill the Commission's stated goals of providing "sufficient incentives for cable operators to invest in [additional channels] while not permitting operators to raise rates to unreasonable

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[2] This pleading is submitted without prejudice to Time Warner's claims and arguments in its pending lawsuits challenging various provisions of the Cable Television Consumer Protection and Competition Act of 1992, Pub. L. 102-385, 106 Stat. 1460 (1992). See Turner Broadcasting System, Inc. v. Federal Communications Commission, No. 92-2247 (D.D.C. April 8, 1993)(U.S. Supreme Court noted probable jurisdiction, No. 93-44, September 28, 1993); Discovery Communications, Inc. v. U.S., No. 93-9150 (D.C. Cir.); Time Warner Entertainment Company, L.P. v. FCC, No. 93-1266 (D.D.C.); Daniels Cablevision, Inc. v. United States, No. 92-2292 (D.D.C. Sept. 16, 1993).

[3] This proposal is discussed in the Third Notice at ¶ 137.

levels."[4] The ease of calculation and resulting certainty of this method provides a positive incentive to cable operators to add channels. That incentive, and the resulting benefit to consumers in the form of increased programming choices, more than offsets the Commission's theoretical yet empirically unsubstantiated concerns that this method could result "in pricing above economies of scale" divined by the Commission.[5] Time Warner thus urges the Commission to adopt this simple and appealing approach to channel additions and deletions.

The Commission's tentative proposal, the third option identified in the Third Notice, to account for channel additions and deletions using the slope of the benchmark curve is conceptually consistent with the benchmark scheme, but therefore replicates all of its flaws. It is unfortunate for cable operators, consumers and the Commission that the tentative proposal is an adornment to a benchmark curve built on exceedingly rickety foundations. The foundations of the benchmark curve, the Commission's database and computation methodology, are so fraught with infirmities that the benchmark rates (and the benchmark curve) do not approach being reliable proxies for the reasonable rates mandated by the Cable Act.[6] It

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[4] Third Notice at ¶ 136.

[5] Third Notice at ¶ 137.

[6] These infirmities have been discussed by Time Warner in several filings in this docket. <u>See</u> Comments to Further Notice of Proposed Rulemaking of Time Warner at 11-15 (filed June 17, 1993); Petition for Reconsideration of Time Warner at 2-4 (filed (continued...)

is unfortunate that these defects in the benchmark curve will be replicated in the pricing of channel additions and deletions. If the Commission opts to proceed with its tentative proposal it should do so only as a temporary measure, while it refocuses its efforts on revising and improving the benchmarks and the methodology employed to derive them.

The Third Notice does not clearly specify how channel additions and deletions are to be priced in systems offering both a basic service tier and one or more cable programming service tiers.[7] Time Warner believes that whatever methodology the Commission settles on, it should be applied <u>within</u> tiers rather than across them in order to prevent anomalous, if not perverse, results. For instance, if the Commission's tentative channel addition/deletion formula is applied across both a basic service tier and a cable programming service tier when a channel is deleted from the latter, basic-only subscribers could be subjected to higher rates without a concomitant increase in their

[6](...continued) June 21, 1993); Reply Comments to Further Notice of Proposed Rulemaking of Time Warner at 11-13 (filed July 2, 1993). Numerous other cable operators have noted similar problems with the benchmark data. <u>See e.g.</u>, Petition for Reconsideration of Booth American Company, Cablevision Industries Corp, <u>et al</u>. at 11-13 (filed June 21, 1993); Petition for Reconsideration of Century Communications Corp. at 6-8 (filed June 21, 1993); Petition for Reconsideration of National Cable Television Association, Inc. at 10-16 (filed June 21, 1993).

[7] Also missing from the Commission's formula is the definition of "programming costs." Time Warner respectfully urges the Commission to define these costs in a straightforward, simply calculable manner. Moreover, for the reasons explained in the text, the programming cost calculation should be tier-specific.

level of service.[8] Even without such increases, considerable customer confusion may result from a rate scheme that requires pricing changes to tiers unaffected by service changes. Such a result is not mandated by the Commission's tier neutral rate regulation scheme and is contrary to the interests of both cable subscribers and operators.

Whatever channel addition/deletion methodology the Commission adopts, it should mandate that rate changes related thereto can be implemented on thirty days notice to the franchising authority. Otherwise, channel additions could be held up indefinitely while franchising authorities review a proposed rate change. A thirty day notice provision, coupled with refund liability if the rate change is eventually found to be incorrectly calculated, protects consumers while affording them the benefits of additional programming at the earliest possible date.

If the Commission adopts a channel addition/deletion methodology which requires a calculation of programming costs, it should prevent local franchising authorities from using a channel addition or deletion as a pretext for exacting proprietary programming cost information from a cable operator.[9] The

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[8] Adding a channel to the cable programming service tier could likewise result in an increase in basic tier rates under the Commission's tentative proposal if the added channel has high programming costs.

[9] The Commission should provide similar protection for cable operators seeking external cost treatment for programming cost increases.

Commission must ensure that proprietary information is not subject to public disclosure and should preempt state/local FOIA laws that do not accord such information an exemption from disclosure at least as strong as the federal FOIA. The Commission should also provide that any programming cost information relevant to channel additions or programming cost increases (i) may be furnished to franchising authorities in an aggregated or redacted format, or (ii) may be verified by third parties rather than provided directly to franchising authorities if such is necessary to adequately assure confidentiality.

II. Cable Operators Should Not Be Forced to Elect Cost-of-Service Throughout for All Regulated Tiers

The Commission should permit cable operators to elect benchmark rate regulation for one tier of service while undertaking a cost-of-service showing for other tiers. Preserving this election would reduce the administrative burdens and social costs attendant to cost-of-service regulation <u>without</u> the feared opportunities for cable operators to "game" the system. Moreover, contrary to the expectations of some, allowing such an election may very well <u>reduce</u> the number of cost-of-service hearings.

The Third Notice tentatively concludes that cable operators should be required to make a single election, noting that such a requirement "best protects [the Commission's] decision to develop a benchmark system based on tier neutrality and also eliminates any incentives to 'game' the regulatory process."[10] The Commission's tentative conclusion is apparently based on claims made by NATOA that a rule that permits a cable operator to use the benchmark regulatory scheme for one tier of service and cost-of-service for the other tier will provide incentives for cable operators to "game" the regulatory process. This "gaming" would supposedly occur by the cable operator moving high-cost programming to the tier for which a cost-of-service showing is elected while leaving low-cost programming on a tier subject to benchmark regulation. This claim is pure fiction -- concocted to justify an arrangement that would discourage cable operators from making a justified cost-of-service showing to the Commission by forcing them into a basic service tier cost-of-service showing on the local level if they do so.

Cable operators simply have no economic incentive under the Rate Order to behave as NATOA alleges. The Rate Order affords external treatment to programming cost increases, thus allowing recovery of such costs on either tier without seeking a cost-of-service showing.[11] The expense and administrative burdens of cost-of-service hearings and the possibility that such hearings could result in below-benchmark rates are incentives that promote use of the benchmarks rather than cost-of-service showings. These pro-benchmark incentives are reinforced by the fact that

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10 Third Notice at ¶ 149.

11 Rate Order at ¶ 251.

programming cost increases are recoverable as external costs under the benchmark regime.

An unstated rationale for forcing cable operators to elect cost-of-service for all regulated tiers is to deter cable operators from undertaking cost-of-service hearings. However, the pro-benchmark incentives discussed above have dispelled initial fears that the Commission would be inundated with cost-of-service hearings. Time Warner and other cable companies have publicly stated their intention to utilize cost-of-service hearings only in exceptional cases.[12] Therefore, a rule compelling uniform elections could actually serve to double the number of cost-of-service hearings sought by such cable operators, rather than discourage such filings. To the extent that the Commission's proposed rule is designed or actually operates to deter cable programming service cost-of-service showings by other cable operators, it pokes holes in the safety net such showings were meant to provide against the possibility of confiscatory rates and raises issues of constitutional dimensions.

Given the administrative burdens attendant to cost-of-service showings, it is unreasonable for the Commission to impose the burdens of cost-of-service regulation on a cable operator that elects to use the benchmark for one tier of service.

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[12] See Communications Daily, Vol. 13, No. 147 (Aug. 2, 1993) at 5. (Time Warner "will use cost-of-service challenges to FCC cable rate rules very sparingly and only in those cases where it is clearly warranted.")

Although the benchmark, by definition, represents a "reasonable" rate, the Commission nevertheless here proposes to require a cost-of-service hearing to justify such rate if a cost-of-service hearing is elected for the other regulated tier. Such a proposal is wasteful and unwarranted -- especially in light of the statutory directive to the Commission to seek to minimize such burdens.[13]

NATOA's suggestion that through tier neutrality the Commission intends "that the same 'reasonable' rate determination be made on both tiers"[14] is without citation or support. Nowhere in the Rate Order or the Third Notice does the Commission state that the rate regulatory scheme must result in the same per channel price for basic and cable programming channels. The benchmarks produce a uniform per channel rate before external costs (such as programming cost increases) are accounted for, but does not contemplate uniform rates. In fact, the Rate Order contemplates different rates for the various tiers as a result of: (1) varying external costs;[15] and (2) timing differences in implementation.

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[13] The Act expressly directs the Commission "to seek to reduce administrative burdens on subscribers, cable operators, franchising authorities, and the Commission" in prescribing regulations. 47 U.S.C. § 543(b)(2)(A).

[14] Third Notice at ¶ 147.

[15] See Rate Order at n. 501.

The Commission correctly prefers the benchmark and price cap approach to cost-of-service showings.[16] In light of this preference and the pro-benchmark incentives the Rate Order provides, the Commission should not seek to impose the burdens associated with cost-of-service showings on cable operators that have adopted its presumptively reasonable benchmark rates for a particular tier. To the extent the Commission's proposal is driven simply by a concern that different procedures may yield different results, that is a concern already addressed and rejected by the Cable Act itself. The Commission is statutorily constrained by the bifurcated jurisdictional framework which is at the heart of the Cable Act.[17]

The Commission is correct in asserting that cable operators should, at the very least, be given "reasonable opportunities" to switch between benchmark and cost-of-service regulation.[18] Rather than mandate that a cable operator wait until the beginning of a calendar year to convert from benchmark to cost-of-service regulation, the Commission should allow a switch at any time there is a reasonable basis (such as an increase in costs) for making the election.

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16 Third Notice at ¶ 153.

17 Where a cable operator voluntarily elects cost-of-service showings for all regulated tiers, it may be more efficient to hold some of the proceedings in common. However, given the statutory design, this must be done exclusively at the federal level, since local franchising authorities have no jurisdiction over cable programming services.

18 Third Notice at ¶ 151.

III. Costs of Upgrades Required or Negotiated By Local Franchising Authorities Should Be Afforded External Cost Treatment

The Third Notice seeks comment on whether the Commission's rules should permit external cost treatment for costs of upgrades required by local franchising authorities.[19] The costs of upgrades required by franchise authorities should not be treated differently than the costs of complying with other franchise requirements -- cable operators should be permitted to pass these costs through to subscribers.[20] Any limitations on the ability of cable operators to recover these costs would deter investment and harm consumers by forcing cable operators through the vagaries of the cost-of-service process in order to recover upgrade costs.

External treatment should be afforded not only to those upgrades required by franchising authorities but also those agreed to by local regulators. In such cases, local authorities have already made a determination that the service and plant improvements will benefit consumers, and thus the passing through of such costs is already deemed (implicitly or explicitly) appropriate. There is no need for the FCC to "second guess" the consensus of the local franchise authority and cable operator.

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[19] Third Notice at ¶ 153.

[20] See Third Notice at ¶ 87. "Cable operators may pass through to subscribers increases in certain external costs to the extent that such increases exceed inflation: . . . costs of franchise requirements including PEG access channels. Franchise fees are also accorded external treatment."

External cost treatment would also foreclose opportunities for abuse by local regulators. Franchising authorities should not be permitted to be both prosecutor and judge by forcing a cable operator to upgrade its system and then "adjudicating" the cost of such upgrades in a cost-of-service hearing. If not an outright invitation to abuse or political manipulation, such a framework at least invites demands for upgrades that are undisciplined, uneconomic and undesired by consumers. Giving external cost treatment to required upgrades brings a degree of discipline to the franchising process by requiring local authorities "to weigh the potential impact of any cost increases on subscribers at the time they require system changes."[21]

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[21] Third Notice at n.160.

IV. Conclusion

For the foregoing reasons, Time Warner respectfully recommends that the Commission adopt rules consistent with the comments herein.

Respectfully submitted,

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